Supreme Court, U.S.
FILED
JUL 24 1998
CLERK

No. 98-7

In The

Supreme Court of the United States

October Term, 1997

CHARLES L. GRIMES,

Petitioner,

v.

VITALINK COMMUNICATIONS CORPORATION,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of Delaware

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Respondent respectfully restates Petitioner's "Questions Presented" as follows:

> When a former corporate shareholder is compensated for his shares in a corporation, which was incorporated, operated, and regulated pursuant to state law, does compensation pursuant to that same statutory scheme, which pre-existed the former shareholder's acquisition of shares, constitute a taking under the Fifth and Fourteenth Amendment to the United States Constitution?

PARTIES TO THE PROCEEDING

In addition to the parties listed in the case caption, the Gadfly Foundation was a co-petitioner (along with Charles Grimes, the Petitioner herein) in the case before the Supreme Court of Delaware.

Vitalink Communications Corporation was wholly acquired by Network Systems Corporation, and, subsequently, Network Systems Corporation was wholly acquired by Storage Technology Corporation. Thus, Storage Technology Corporation is the successor in interest to Vitalink Communications Corporation.

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U.S. Const. amend. V ..... *passim*

U.S. Const. amend. XIV, § 1 ..... *passim*

8 Del. Code §§ 101-619 (General Corporation Law) ... 2, 5

8 Del. Code § 251 2

8 Del. Code § 262 ..... 2, 3

STATEMENT OF THE CASE

Respondent agrees with Petitioner's Statement of the Case, with the following exceptions:

1. As more fully explained *infra*, Respondent disagrees with Petitioner's characterization of Respondent's actions under Delaware law in merging Vitalink Communications Corporation ("Vitalink") into Network Systems Corporation ("NSC") as effecting a "taking" as the term is used in the Fifth and Fourteenth Amendments. (*See* Petition For A Writ of Certiorari ("Pet. Br.") at 2 (characterizing the July 1, 1991 merger as the "time of taking").)

2. The "discount rate" used by the experts in valuing Vitalink based on future cash flows reflects, among other factors, the relative risk inherent in Vitalink's achievement of those future cash flows. Because Vitalink was a relatively high risk company, its future cash flows were discounted by a relatively high rate in order to arrive at Vitalink's current (as of July 1, 1991) value. There was no logical basis for the Delaware courts to, in effect, guarantee Petitioner a high rate of return simply because he chose to make a high risk investment. (*See* Pet. Br. at 2-3 (characterizing the discount rate as reflective of Vitalink's earning power).)

3. The Delaware Court of Chancery rejected Petitioner's argument because it recognized that Petitioner had failed to provide any logical explanation of why the discount rate reflected Petitioner's lost use of his funds. (Pet. Br., Appendix B at 29a (Court of Chancery Opinion); *see* Pet. Br. at 3 (asserting that the Court of Chancery provided no reason for rejecting Petitioner's theory).)

REASONS FOR DENYING THE WRIT

This Court should deny Petitioner's writ because, under the Court's well settled takings jurisprudence, nothing was taken from Petitioner such as to invoke the just compensation requirement of the Fifth and Fourteenth Amendments. Petitioner's property rights (i.e. his shares in Vitalink) were created under and regulated by Delaware corporations law, and nothing was "taken" from Petitioner when his shares were acquired and paid for by NSC pursuant to that same Delaware law. Petitioner has presented no questions worthy of this Court's attention under Rule 10, and Petitioner's request should be denied.

A. Under Delaware Law, Petitioner Has No Property Right To Any Interest At All – Much Less Any Particular Interest Rate.

Vitalink incorporated and issued shares of stock under Delaware law. *See generally* 8 Del. Code §§ 101-619 (Delaware General Corporation Law). NSC acquired Petitioner's shares in Vitalink pursuant to Delaware law, *see* 8 Del. C. § 251, and Petitioner brought his action seeking appraisal of his shares of stock in Vitalink under Delaware law, *see* 8 Del. C. § 262. When Petitioner acquired his subject property rights, these rights arose out of and were already subject to Delaware General Corporations Law. Shares of stock in Vitalink[1] were wholly a creature of

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[1] Vitalink issued the public stock in question in the 1980's, long after the establishment of forced mergers and appraisal actions under Delaware law.

statute and their ownership was fully subject to regulation by statute.

Fifty years ago, the Delaware Supreme Court affirmed a decision of the Delaware Court of Chancery rejecting the very same argument put forth by Petitioner today. *Meade v. Pacific Gamble Robinson Co.*, 51 A.2d 313, 318 (Del. Ch. 1947), *aff'd*, 58 A.2d 415 (Del. 1948). The Delaware courts held that a petitioner seeking stock appraisal rights under Delaware law had no right to interest at all – much less a right to any particular rate of interest. *Id.* Today, the appraisal statute specifically provides that the Court of Chancery may, in its sole and absolute discretion, award a fair rate of interest, if it so chooses. 8 Del. C. § 262(h); *Rapid-American Corp. v. Harris*, 603 A.2d 796, 808 (Del. 1992).

Petitioner argues that the Fifth and Fourteenth Amendment entitle him to a specific rate of interest in a Delaware appraisal action, despite the well settled Delaware law to the contrary. In effect, Petitioner is arguing that the appraisal provision of the Delaware Code is facially violative of the Fifth and Fourteenth Amendments, and the state of Delaware has no right to define the attributes of stock ownership under its corporations law.[2] Petitioner argues that the statutory rate of interest fails to provide just compensation; however, Petitioner

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[2] If in fact Petitioner has called into question the constitutionality of Delaware's appraisal statute, then Petitioner is required to comply with Rule 29.4(c) and provide notice to the state of Delaware. There is no indication in Petitioner's brief that he has so complied.

has no Constitutional right to any compensation whatsoever because there has been no taking under the Fifth and Fourteenth Amendments.

B. The Acquisition of and Payment for Petitioner's Shares in Vitalink Pursuant to Delaware Corporations Law Was a Valid Exercise of the Police Powers of the State of Delaware and Was Not, Therefore, a Compensable Taking under the Fifth and Fourteenth Amendments.

Not every deprivation of property is compensable as a taking under the Fifth and Fourteenth Amendments. A state may exercise its police power to regulate its commerce and industry for the general wealth and prosperity of its people without invoking the takings clause of the Fifth and Fourteenth Amendments. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1022-23 (1992); *Mugler v. Kansas*, 123 U.S. 623, 658, 663 (1887). Property rights arising under state law are held subject to regulation and limitation pursuant to the state's police power. *Lucas*, 505 U.S. at 1027; *Mugler*, 123 U.S. at 665. In the case of personal property (e.g. shares in Vitalink), the state traditionally exercises a "high degree of control over commercial dealings" of which an owner of such property ought to be aware. *Lucas*, 505 U.S. at 1027-28. These regulations pursuant to the state's police power shape the content of the "bundle of rights" held by the property owner. *Id.* at 1027.

The state of Delaware has enacted a comprehensive General Corporation Law covering, *inter alia*, formation, stock issuance, governance, and mergers, including rights of dissenting shareholders to compensation pursuant to

statutory appraisal. *See generally* 8 Del. C. §§ 101-619. Petitioner's shares in Vitalink were held by Petitioner subject to Delaware's General Corporation law, and the acquisition of and payment for those shares pursuant to the valid exercise of the police powers of the state of Delaware did not effect a compensable taking under the Fifth and Fourteenth Amendments.

Petitioner acknowledges that his rights as a shareholder arise from and are subject to the General Corporation Law of Delaware. (Pet. Br. at 8.) However, Petitioner argues that a "squeeze out" of a minority shareholder is nevertheless a taking subject to the just compensation requirements of the Fifth and Fourteenth Amendments. (Id.) In support of this proposition, and in contradiction to this Court's long standing takings jurisprudence, Petitioner cites two cases: *Beerly v. Department of the Treasury*, 768 F.2d 942, 948 (7th Cir.), *cert. denied*, 475 U.S. 1010 (1985) and *Offield v. New York, New Haven & Hartford R.R. Co.*, 203 U.S. 372 (1906).

In *Beerly*, the Seventh Circuit addressed due process issues, 768 F.2d at 947 – not present in the instant case – and the court specifically declined to address the question of just compensation, *id.* at 949. In addition, *Beerly* involved the "squeeze out" of a shareholder pursuant to federal – not state – law. *Id.* at 944. Thus, *Beerly* does not stand for the proposition that the "squeeze out" of a corporate shareholder pursuant to state law effects a compensable taking. To the extent that the logic of *Beerly* may be extended to a "squeeze out" pursuant to state law, it is simply inconsistent with this Court's takings jurisprudence.

In *Offield*, this Court held that a takings claim based on the forced acquisition of shares of railroad stock pursuant to a particular state law was not frivolous and, therefore, upheld the state high court's decision to deny a demurrer. 203 U.S. 375-77. The case provided absolutely no analysis of or reference to this Court's line of cases holding that valid exercises of a state's police powers do not constitute a compensable taking.

C. The Application of Delaware Law to Petitioner's Shares in Vitalink was Just and Fair and Does Not, Therefore, Constitute a Compensable Taking.

More recently, this Court's takings cases have focused on the "justice and fairness" of any governmental deprivation and have relied on a three factor analysis in determining whether to invoke the just compensation requirements of the Fifth and Fourteenth Amendments: (1) the economic impact of the regulation; (2) the extent to which the regulation interferes with investment backed expectations; and (3) the character of the governmental action. *Eastern Enterprises v. Apfel*, 1998 U.S. Lexis 4213, *45-46, 51 (June 25, 1998). Each of these factors undermines Petitioner's attempts to characterize the Delaware General Corporation Law as effecting a taking in this case.

1. The Economic Impact of the Regulation on Petitioner Has Been Minimal.

Petitioner has in fact been compensated for his shares of stock in Vitalink. He received fair value for his shares pursuant to an appraisal action to value the shares before

the Delaware Chancery Court, and he received interest on that value at the statutory rate, compounded monthly, from the time of the merger until the time he received payment. Petitioner's sole claim is that the statutory interest rate[3] was inadequate. In *Seaboard Air Line Ry. Co. v. United States*, 261 U.S. 299 (1923) – the case upon which Petitioner relies to establish his right to interest in the event of a compensable taking – this Court stated that the payment of interest at the statutory rate was "palpably fair and reasonable" as just compensation. *Id.* at 306. Thus, any economic impact on Petitioner as a result of the loss of and statutory compensation for his shares has been minimal.

2. A Shareholder in a Delaware Corporation Cannot Reasonably Expect to Avoid the Application of Delaware General Corporation Law to His or Her Shares.

When a party acquires a property right subject to regulation, the imposition of such regulation on the subject property right does not constitute a taking because it cannot be said to interfere with the party's investment backed expectations. *Eastern Enterprises*, 1998 U.S. Lexis 4213, *53-54; *Lucas*, 505 U.S. at 1016 (majority opinion), 1034 (Kennedy, J., concurring).

The right of a corporation to force a merger on dissenting minority shareholders under certain conditions pursuant to statute is well established under Delaware

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[3] Under Delaware law, this was the Federal Reserve Discount rate plus four percentage points.

law, as are the appraisal rights of such a dissenting shareholder. Petitioner bought his stock subject to the Delaware General Corporation Law and cannot now claim that his loss of and payment for those shares pursuant to Delaware law has interfered with his reasonable investment backed expectations.

3. The Regulation Under Which Petitioner Lost His Shares and Received Compensation is Uniformly Applied to Dissenting Shareholders Who Lose Their Shares in Delaware Corporations.

Restrictions that are reasonably related to implementation of a policy for the general public welfare are less likely to effect a taking to the extent that they are widely applicable to all similarly situated property. *Lucas,* 505 U.S. at 1023. The Delaware General Corporations Law is uniformly applicable to all Delaware corporations and their shareholders. Its application to Petitioner consistent therewith does not effect a compensable taking under the Fifth and Fourteenth Amendments.

CONCLUSION

Petitioner has been fully and fairly compensated for his shares in Vitalink pursuant to settled Delaware corporations law, and such events do not give rise to a takings claim under the Fifth and Fourteenth Amendments to the United States Constitution. This Court's takings jurisprudence is clear and consistent on this issue, and

Petitioner's request for a writ of *certiorari* should be denied.

Dated: July 24, 1998.

Respectfully submitted,

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